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No. 95-725

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1995

ALFA-LAVAL FOOD & DAIRY CO.,
AND ALFA-LAVAL CREDIT AB,
Petitioners,
v.
BRITZ, INC., HELM CONCENTRATES, INC.
AND HELM TOMATOES, INC.,
Respondents.

On Petition For Writ Of Certiorari
To The Supreme Court Of California

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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36 pp

QUESTIONS PRESENTED

1. Is the petition to this Court premature where this case is presently being litigated in the state trial court and subject to review by the State Appellate Court and the California Supreme Court?

2. Should this Court review a State Appellate Court decision—when no final disposition exists because the matter is on remand to the trial court for an evidentiary hearing on arbitrator bias and to confirm or vacate the arbitration award—where Petitioners do not assert that the case falls within any of the four categories of cases considered final for purposes of 28 U.S.C. section 1257 despite pending trial court proceedings?

3. Did the State Appellate Court correctly decline to read AAA Commercial Arbitration Rule 19 to abrogate judicial review of arbitrator bias and hold that a trial court considering a petition to confirm or vacate an arbitration award is required to determine, *de novo,* whether the circumstances disclose a reasonable impression of arbitrator bias?

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STATEMENT OF THE CASE

In late 1989 Respondents Britz, Inc., Helm Concentrates, Inc. and Helm Tomatoes, Inc. ("Helm") prepared to build a tomato processing plant. After consulting with manufacturers and engineers, Helm obtained machinery, equipment, and consulting services from Petitioners Alfa-Laval Food & Dairy Co. and Alfa-Laval Credit AB ("Alfa-Laval")—a large Swedish engineering and manufacturing concern. Helm selected Alfa-Laval primarily because of Alfa-Laval's warranties and representations on the capabilities and reliability of its paste sterilization equipment.

The Alfa-Laval equipment failed to perform as represented. The failure of Alfa-Laval's equipment cost Helm its business. Helm's losses, including lost profits and expenses incurred in attempting to make the equipment perform as warranted, exceeded $5 million dollars. Helm lost an additional $10 million dollars when forced to sell the tomato processing plant.

In September 1990, Helm sued Alfa-Laval for rescission of the parties' agreement and damages. Alfa-Laval successfully petitioned the Fresno County Superior Court to compel arbitration of the dispute. The parties' agreement provided for submission of controversies and claims to arbitration. See, Petition for Cert. p. 3. The parties' agreement also contained a choice of law provision:

> "Section 15. . . is modified as follows: (1) the governing law shall be the law of the state of California, (2) arbitration shall be in Fresno, and (3) the prevailing party in the arbitration shall be entitled to reasonable attorneys' fees."

Following the Superior Court's granting of Alfa-Laval's petition to compel arbitration, the American Arbitration Association ("AAA") appointed John Peterson, a partner in the Fresno, California law firm of Jory, Peterson &

Sagaser, as arbitrator. Helm accepted Peterson as the arbitrator—neither Helm nor its counsel possessed any facts that caused them to believe Peterson might be biased in favor of Alfa-Laval.

Arbitration on the issue of liability commenced in January 1992. The Chicago law firm of Wildman, Harrold, Allen & Dixon ("Wildman, Harrold") and attorney Craig White ("White") acted as Alfa-Laval's primary counsel before the arbitrator. The Fresno firm of McCormick, Barstow, Sheppard, Wayte & Carruth ("McCormick, Barstow"), Alfa-Laval's primary superior court counsel, actively worked with the Wildman, Harrold firm on various aspects of the arbitration, and even requested and obtained affirmative relief for Alfa-Laval from the arbitrator. Appendix to Opposition to Petition for Certiorari pp. A-1 through A-7.

The arbitrator issued his interim award in May 1992. Arbitrator Peterson concluded that Alfa-Laval's performance representations concerning its machinery and equipment were not representations of material fact and that, in any event, "the. . . shut-down and run times language is not essential to the purpose of the Alfa-Helm Agreement." App. to Opp. to Petition for Cert. pp. A-15, A-27. The arbitrator also decided that each side would bear its own fees and costs. App. to Opp. to Petition for Cert. p. A-23.

On June 22, 1992, Robert Glassman of Helm, spoke on the telephone with Marshall Whitney, a senior member of McCormick, Barstow. App. to Opp. to Petition for Cert. p. A-36. After Mr. Glassman told attorney Whitney that arbitrator Peterson issued an interim arbitration award against Helm, Whitney said "He had personally made two or three referrals to John Peterson recently, within that last year or two. . . ." App. to Opp. to Petition for Cert. p. A-36. Glassman told Helm's trial and arbitration attorney, Ted Frame, about Whitney's remark. Two days later Frame sent the first of several written requests for disclosure of cases or

other legal matters referred to arbitrator Peterson's law firm by any of the attorneys in the McCormick, Barstow firm or visa-versa within 3 years of Peterson's appointment as arbitrator. Peterson's responses to inquiries from Frame began to trickle in on June 25, 1992.

Initially, Peterson revealed no conflict of interest facts and declared "there is no special relationship between me or our firm and the McCormick, Barstow firm." App. to Opp. to Petition for Cert. p. A-38. Peterson acknowledged only that his firm was on McCormick, Barstow's list of referral firms.

Peterson offered no further response until July 9, 1992, and then only following a flurry of letter exchanges between White, Frame, and the AAA. At that time, in light of Frame's demands, Peterson wrote "In the past, when I have arbitrated a matter involving a party represented by the McCormick, Barstow firm, I have advised the American Arbitration Association that I have been on McCormick, Barstow's referral list. I would have done so in this case had I believed that McCormick, Barstow represented Alfa-Laval in the arbitration, or in any other capacity." App. to Opp. to Petition for Cert. p. A-41. Yet, Peterson acknowledged he knew McCormick, Barstow represented Alfa-Laval "in [another] capacity." "I knew in April 1991, that McCormick, Barstow represented Alfa-Laval in the superior court action." App. to Opp. to Petition for Cert. pp. A-41 through A-42.

Following another flurry of letters between White, Frame and the AAA, on July 15, 1992 Peterson finally revealed the extent of his business relationship with McCormick, Barstow. Peterson admitted that McCormick, Barstow referred six new legal matters to him personally or to his firm—within 18 months of his appointment as the arbitrator in this case. App. to Opp. to Petition for Cert. pp. A-46 through A-52. Later, it was shown that McCormick, Barstow referred a seventh matter to Peterson or to his firm

within the same period. App. to Opp. to Petition for Cert. p. A-55. Most importantly, midway through his six page letter, Peterson revealed the existence of the ongoing pecuniary business relationship he had with McCormick, Barstow as an expert witness while arbitrating the instant matter:

"C. I was consulted and agreed to serve as an expert witness in these matters in which McCormick, Barstow represented attorney firms as legal malpractice defendants:

(1) *Forte v. Lang, Richert & Patch*
I was initially contacted in late 1984 or early 1985. I provided deposition testimony and trial testimony on behalf of defendants. The case resolved favorably to defendants in September 1985.

(2) *Bilyeu v. Baker, Manock & Jensen*
Larry Wayte of the McCormick, Barstow firm contacted me in about November 1991. I have reviewed the pertinent transcripts and documents in the case, and provided an oral opinion to Mr. Wayte. If this matter goes to trial, I expect to testify.

(3) *Fansler v. Motschiedler, Michaelides & Wishon*
Marshall Whitney of the McCormick, Barstow firm contacted me in December 1991 regarding testimony in this case. I have reviewed appropriate documents and transcripts, provided an oral opinion, and given deposition testimony. If this case goes to trial, I expect to testify."

App. to Opp. to Petition for Cert. pp. A-49 and A-50.

Peterson admitted that just weeks before the arbitration began, McCormick, Barstow hired him twice (in November 1991 and December 1991) as an expert witness for McCormick, Barstow in other matters. Put plainly, Peterson was on McCormick, Barstow's payroll while he arbitrated the Alfa-Laval/Helm dispute and while McCormick, Bar-

stow actively represented Alfa-Laval in the litigation and the arbitration.

Armed with these admissions, Helm asked the AAA to remove Peterson and appoint a new arbitrator. App. to Opp. to Petition for Cert. pp. A-59 through A-67. The AAA wrote the parties on August 4, 1992, affirming the continued service of Peterson as arbitrator. App. to Opp. to Petition for Cert. pp. A-68 and A-69.

Helm sought reconsideration from the AAA on February 4, 1993. App. to Opp. to Petition for Cert. pp. A-70 through A-78. On February 18, 1993 the AAA reaffirmed Peterson's continuing service as arbitrator. App. to Opp. to Petition for Cert. pp. A-79 and A-80. Helm unsuccessfully petitioned the Fresno County Superior Court to vacate the interim award, and the California Fifth Appellate District Court of Appeal ("Appellate Court") denied Helm's petition for extraordinary relief without comment.

The damages phase of the arbitration began in February 1993. Peterson issued his opinion and final award on March 31, 1993. Peterson awarded Alfa-Laval $587,425.00—as payment for the tomato processing equipment that by then had been scrapped—and Helm nothing. App. to Opp. to Petition for Cert. pp. A-81 through A-83. Peterson also reversed the decision he made in his interim award (that each side was to bear its own fees and costs), and awarded fees and costs to Alfa-Laval by supplemental award for a total award of $2,109,701.10. App. to Opp. to Petition for Cert. pp. A-84 through A-88.

Helm petitioned the Fresno County Superior Court, pursuant to California Code of Civil Procedure section 1286.2, to vacate the final arbitration award as supplemented by the fee and cost award of May 10, 1993, based on arbitrator bias. Alfa-Laval filed cross-motions to dismiss Helm's petition, and to confirm the awards. Alfa-Laval argued: (1) The

AAA's determination that the arbitrator need not be removed was a "plausible" decision entitled to judicial deference; (2) no reasonable impression of bias existed because McCormick, Barstow was counsel for Alfa-Laval only in the Superior Court proceedings; and (3) Helm "waived" its right to object to Peterson serving as arbitrator because Helm knew there had been a Peterson-McCormick, Barstow business relationship in 1985 and, armed with that knowledge, should have asked about the parties' present business relationships. The Superior Court in essence agreed with Alfa-Laval.

After the Superior Court entered judgment, Helm timely filed a notice of appeal with the Appellate Court on September 14, 1993. The Appellate Court issued its opinion on May 8, 1995, reversing the Superior Court's decision in part, and remanding the matter for an evidentiary hearing on the arbitrator's bias.

The Appellate Court held, in pertinent part, as follows on the issue of the standard of review:

> "In light of the explicit statutory authorization of judicial determination of 'evident prejudice' of arbitrators as interpreted in *Commonwealth Corp., supra*, 393 U.S. 145, 89 S.Ct. 337 we hold that a trial court considering a petition to confirm or vacate an arbitration award is required to determine, de novo, whether the circumstances disclose a reasonable impression of arbitrator bias, when that issue is properly raised by a party to the arbitration."

App. to Petition for Cert. p. 20.

The Appellate Court issued a modification of opinion upon denial of rehearing. App. to Petition for Cert. p. 65. On August 10, 1995, the California Supreme Court denied Alfa-Laval's request for review, without comment. App. to Petition for Cert. p. 29.

LAW AND ARGUMENT

A. THE PETITION IS PREMATURE AS NO FINAL DISPOSITION EXISTS BECAUSE THE MATTER IS ON REMAND TO THE STATE SUPERIOR COURT FOR AN EVIDENTIARY HEARING AND PETITIONERS FAIL TO SHOW THIS MATTER FALLS WITHIN ANY OF THE FOUR CATEGORIES OF CASES WHERE A STATE COURT DETERMINATION IS FINAL FOR PURPOSES OF 28 U.S.C. SECTION 1257 DESPITE PENDING STATE TRIAL COURT PROCEEDINGS

Petitioners fail to show that this matter falls within any of the four categories of cases in which a state court determination is treated as final under 28 U.S.C. section 1257 where additional proceedings are pending in the state trial court. See, *Cox Broadcasting Corp. v. Cohn*, 429 U.S. 469, 479-484 (1975).[1] No final disposition exists. The Appellate Court remanded the case for an evidentiary hearing on

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[1] As a threshold matter, Petitioners seek a writ to the wrong court. Petitioners assert jurisdiction exists pursuant to 28 U.S.C. section 1257 (a) because "the decision below . . . concerns Petitioner's ' "[r]ights . . . claimed under the . . . statutes of . . . the United States [Citation omitted]." ' " Petition for Cert p. 2. The California Supreme Court declined Petitioners' request for review. App. to Petition for Cert. p. 29. Where discretionary review by a higher state court is denied, the intermediate appellate court judgment is the highest court from which review is sought. See, e.g., *Perry v. Thomas*, 482 U.S. 483, 489 (1987) (appeal pursuant to former 28 U.S.C. 1257 subdivision (2) appropriate from Second Appellate District Court of Appeal where California Supreme Court denied review); *American Railway Express Company v. Levee*, 263 U.S. 19, 20-21 (1923) (writ of certiorari properly addressed to court of appeal since Louisiana Supreme Court jurisdiction is discretionary and that court declined jurisdiction); *Michigan-Wisconsin Pipe Line Co. v. Calvert, Comptroller of Public Accounts, et al.*, 347 U.S. 157, 159-160 (1954) (appeals under former 28 U.S.C. section 1257 dismissed because made from Texas Supreme Court and not Civil Court of Appeals where Texas Supreme Court refused review). The petition here seeks a writ of certiorari to the California Supreme Court, instead of the California Fifth Appellate District Court of Appeal. In addition, the Appellate Court no longer has jurisdiction as the remittitur issued on August 18, 1995. Thus, the petition is inappropriate.

arbitrator bias, waiver of objection to bias, and a determination to vacate or confirm the arbitrator's award. If the award is vacated, the arbitration begins anew. If no partiality is found or objection to partiality was waived, then judgment shall be reinstated. App. to Petition for Cert. pp. 65-67. In short, Petitioners prematurely seek review from this Court when there is yet to be a decision from the Superior Court with probable review by the Appellate Court and the California Supreme Court.

Petitioners ignore the limited exceptions applied by this Court, pursuant to *Cox Broadcasting Corp. v. Cohn*, 429 U.S. 469, 479-484, to hear matters notwithstanding pending trial court proceedings: (1) Petitioners make no showing that a federal issue is conclusive and that the outcome of the further proceedings is preordained; (2) Petitioners make no showing that a federal issue requires decision despite the outcome of the future state court proceedings—although Petitioners argue that contracts will be disturbed as a result of the Appellate Court determination, as discussed below, that determination does nothing more than confirm statutory and decisional law allocation of power to the courts to review arbitrator bias; (3) Petitioners make no showing that a federal question has been finally decided and later review of the federal issue cannot be had whatever the outcome of the case; and (4) Petitioners make no showing that absent immediate review by this Court, the state court decision would result in serious erosion of federal policy. Because this case does not fall within any of the exceptions carved out in *Cox Broadcasting Corp. v. Cohn*, 429 U.S. 469, the petition is premature and should be denied.

B. THE STATE APPELLATE COURT CORRECTLY DECLINED TO ALLOW AAA COMMERCIAL ARBITRATION RULE 19 TO ABROGATE JUDICIAL REVIEW OF ARBITRATOR PARTIALITY BECAUSE STATUTORY AND DECISIONAL LAW RESERVES THE FINAL DECISION ON ARBITRATOR BIAS FOR THE COURTS UPON A PETITION TO VACATE OR CONFIRM AN ARBITRATION AWARD

Petitioners cast the issue as follows: "The lower court's mandated de novo review of the AAA's 'conclusive' decision overruling a party's objection to the arbitrator is simply a refusal to enforce the parties' agreement to arbitrate according to the AAA Commercial Arbitration Rules." Petition for Cert. p. 14. Petitioners argue that this is in contravention of Section 4 of the Federal Arbitration Act, providing that a federal court may issue an order directing that the arbitration "... proceed in the manner provided for in such agreement."

Petitioners misapprehend the applicability of provisions of the Federal Arbitration Act, 9 U.S.C. section 1 *et seq.* ("FAA") and attempt to graft a procedural provision of the FAA onto a state court analysis to argue that a federal court would read the agreement and AAA Commercial Arbitration Rule 19 differently than the State Appellate Court.

The Appellate Court stated that "[t]he parties impliedly agree that this case is governed by the Federal Arbitration Act...." App. to Petition for Cert. p. 6. The parties' agreement, however, included a choice of law provision that made clear: "(1) *the governing law shall be the law of the State of California,* (2) arbitration shall be in Fresno [California]...." In *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University,* 489 U.S. 468, 477-479 (1989) this Court held that parties remain free to include a choice of law provision providing which state law governs the arbitration claims to which the

arbitration provision of the contract applies.[2] Here, Petitioners' insistence on enforcement of the contract according to its terms under the auspices of section 4 of the FAA is undercut by the existence of the choice of law provision providing for the application of California law and by the parties' reliance on the California Arbitration Act when petitioning the Superior Court to vacate or confirm the arbitration award.

In addition, this Court has never held that FAA section 4 applies in state court proceedings. In *Volt Information Sciences,* 489 U.S. 468, the appellee argued that California Code of Civil Procedure section 1281.2 (incorporated through the choice of law provision in the parties' contract) conflicted with FAA section 4. This Court clarified it had no need to decide whether FAA sections 3 and 4 applied in state court proceedings because, even if fully applicable to state court proceedings, FAA sections 3 and 4 do not foreclose utilization of the California Code of Civil Procedure—the choice of law clause does not offend federal policy. *Id.,* p. 479-480. In so doing, this Court noted FAA section 4 is not applicable to state court proceedings:

> While we have held the FAA's "substantive" provisions—§§ 1 and 2—are applicable in state as well as federal court, see *Southland Corp. v. Keating,* 465 U.S. 1, 12 (1984), we have never held that §§ 3 and 4, which by their terms appear to apply only to proceedings in federal court, see 9 U.S.C. § 3 (referring to 'proceedings brought in any of the courts of the United States'), are nonetheless applicable in state court. See *Southland Corp. v. Keating, supra,* at 6, n. 10 (expressly reserving the question whether '§§ 3 and 4 of

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[2] See, also, e.g., *Nida Engalla, et al. v. Permanente Medical Group, Inc., et al.,* 37 Cal.App.4th 497, 520-521, 43 Cal.Rptr.2d 621 (1995) (Even where underlying contract involves interstate commerce, parties remain free to include choice-of-law provision).

> the Arbitration Act apply to proceedings in state courts'); see also *id.*, at 29 (O'Conner, J., dissenting) (§§ 3 and 4 of the FAA apply only in federal court).

Id., 489 U.S. at p. 477, n.6.

Petitioners' argument would make every state court analysis of an arbitration agreement subject to federal court review to ascertain whether the federal court would have enforced the contract in the same manner under the authority of FAA section 4. This misconceives the effect of the FAA on state law determinations. This Court held that, recognizing Congress' purpose in providing that the FAA ensure private arbitration agreements are enforced according to their terms, the FAA preempts state laws that require a judicial forum, not arbitration, for resolution of claims. *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University,* 489 U.S. 468, 478. It does not follow that how a federal court might read and enforce an arbitration agreement preempts the Appellate Court's construction here, which merely affirmed existing federal and state statutory grounds and case law upon which courts may vacate an arbitration award. "[T]he interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review." *Volt Information Sciences,* 489 U.S. at p. 474; See also, *Fox Film Corp. v. Muller,* 296 U.S. 207 (1935) (where judgment of state court rests upon two grounds, one federal and the other nonfederal, this Court will not review if nonfederal ground independent and adequate to support judgment).

Even if Petitioners' premise that the parties' agreement should be construed as a matter of federal law is arguably tenable, nevertheless, both the text of AAA Commercial Arbitration Rule 19 and federal decisional law supports the Appellate Court's determination—there is no discord be-

tween the Appellate Court decision, federal court precedent, and the holdings of this Court.

AAA Commercial Arbitration Rule 19 provides:

> Disclosure and Challenge Procedure—Any person appointed as neutral arbitrator shall disclose to the AAA any circumstance likely to affect impartiality, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their counsel. Upon receipt of such information from the arbitrator or another source, the AAA shall communicate the information to the parties and, if it deems it appropriate to do so, to the arbitrator and others. *Upon objection of a party to the continued service of a neutral arbitrator, the AAA shall determine whether the arbitrator should be disqualified and shall inform the parties of its decision, which shall be conclusive.*

Petition for Cert. p. 5; italics added.

A fair reading of the italicized language allows for the AAA administrator's determination to be conclusive as to the continued service of the arbitrator *in the arbitration proceeding,* thus parties are precluded from *interlocutory* judicial intervention prior to the conclusion of the arbitration. Arbitrator Peterson did not disclose his connection to McCormick, Barstow, pursuant to the first sentence of AAA Commercial Arbitration Rule 19, until after the issuance of his interim award on liability and after repeated demands for disclosure. App. to Opp. to Petition for Cert. pp. A-46 through A-52. The court in *Merit Insurance Co. v. Leatherby Insurance Co.*, 714 F.2d 673, 681 (7th Cir. 1983) reasoned that because the AAA ethical standards do not have the force of law (even where failure to disclose is a material violation of those standards), it does not follow that the award will automatically be nullified by a court. This is

because the AAA, competing with others offering such service, may "set its standards as high or as low as it thinks its customers want," but the standards it sets in its code of ethics "does not lower the threshold for judicial intervention." *Id.* p. 681.

Under *Merit Insurance Co. v. Leatherby Insurance Co.*, 714 F.2d 673, Peterson's failure to disclose to the AAA, in compliance with the first sentence of AAA Commercial Arbitration Rule 19, would not alone *lower* the threshold for vacating the award. By parity of reasoning, any standards set by the AAA for arbitrator bias, and the AAA review of claims of bias pursuant to the last sentence of AAA Commercial Arbitration Rule 19, cannot *raise* the threshold for judicial review of arbitrator bias.

Petitioners' reading, on the other hand, goes too far—it subjugates the statutory and decisional law power of the courts to review arbitrator bias after the arbitration award is issued to the procedural rules of the AAA.[3] Petitioners' misplaced reliance on section 4 of the FAA would result in the abrogation of section 10 of the FAA which provides that a federal court may vacate the award upon application by a party to the arbitration "[w]here there was evident partiality . . . in the arbitrators . . . ." See, also, *Commonwealth Coatings Corp. v. Confidential Casualty Co.*, 393 U.S. 145 (1968). Petitioners' reasoning fails to acknowledge that AAA rules do not have the force of law. (See, *Merit Insurance Co. v. Leatherby Insurance Co., 714 F.2d 673, 680).*

Petitioners argue that allowing the AAA to finally determine arbitrator bias preserves the integrity of the arbitration process. See, Petition for Cert. pp. 24-26. The Appellate

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[3] See, e.g., *Gebers v. State Farm General Insurance Company*, 38 Cal.App.4th 1648, 45 Cal.Rptr.2d 725 (1995) (insurance company could not dilute the legislative mandate requiring appraiser impartiality by using a policy provision that described the appraisers as "independent.")

Court decision, however, is in harmony with the fundamental principle that justifies narrow judicial review of the merits of an arbitrator's award and thereby preserves the cornerstone of impartiality upon which arbitration rests. Arbitrators are free to decide the merits of the controversy with limited judicial review, provided the arbitrator is neutral, detached, and impartial. To safeguard this cornerstone, Congress, in enacting section 10 of the FAA, and the California legislature's enactment of Code of Civil Procedure section 1286.2, reserved for the courts the final determination of arbitrator partiality or bias. Accordingly, federal courts reviewing challenges to arbitrator partiality under the FAA reason that it is for the court to ultimately decide whether the award should be vacated. The courts have been reluctant to entertain review of arbitrator partiality only where the parties, with knowledge of possible bias, fail to raise an objection during the arbitration process.

For example, the court in *San Carlo Opera Co. v. Conley*, 72 F.Supp. 825 (S.D.N.Y 1946) *aff'd*, 163 F.2d 310 (2nd Cir. 1947) concluded that where a party timely objects to an arbitrator based on bias, and the AAA overrules the objection, the party must proceed with the arbitration; the party will not, however, be precluded from reasserting the bias issue before a court upon a petition to vacate the award. See, also, e.g., *Rogers v. Schering Corporation*, 165 F.Supp. 295 (D.C.N.J. 1958), *aff'd*, 271 F.2d 266 (3rd Cir. 1959) (counsel learned of arbitrator bias from source other than AAA and objected to continuing service of arbitrator at very next hearing. The objection was found to be timely made and preserved for district court review).

Similarly, in *Health Services Management Corp v. Hughes*, 975 F.2d 1253, 1263 (7th Cir. 1992), the court reasoned that if counsel objected to the arbitrator under AAA Construction Industry Arbitration Rules, his objection is preserved for the court's subsequent review; in failing to

object to the AAA, the party waived the right to object. If, however, as in the instant manner, the party has no knowledge of the ongoing business relationships of the arbitrator giving rise to the issue of arbitrator bias, there can be no waiver. *Id.*, at p. 1260. In *Smith v. Prudential Securities*, 846 F.Supp. 978, 980 (M.D. Fla. 1994), the court entertained a challenge of partiality even where the party failed to object to the AAA after disclosure. The court, nevertheless, concluded that the party failed to sustain its burden of showing evident partiality under the FAA.

In sum, instead of deference, the test applied by courts for reviewing failure of an arbitrator to disclose is that articulated by the Court in *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145. To the extent the Appellate Court decision held that a court reviews arbitrator bias *de novo* (without deference to the AAA), the Appellate Court's reasoning is consistent with prior federal decisions and represents a natural expression of existing federal precedent.

Because federal authority is consistent with the decision of the Appellate Court, Petitioners' claim that the Appellate Court decided an important question of federal law which has not been, but should be, settled by this Court lacks merit. See, Pet. for Cert. p. 2. Even if federal cases dealing with the issue of review of an arbitration award, where parties resorted first to the arbitration rules for a decision on arbitrator partiality, did not expressly use the phrase "*de novo*" review, their holdings impliedly support this standard—courts defer to an arbitration body's decision on bias only where the party seeks judicial intervention before conclusion of the arbitration proceedings, or where a party with knowledge of bias, fails to timely object. See, e.g., *San Carlo Opera Co. v. Conley*, 72 F.Supp. 825; *Rogers v. Schering Corporation*, 105 F.Supp. 295; *Health Services Management Corp. v. Hughes*, 975 F.2d 1253; *Smith v.*

Prudential Securities, 846 F.Supp. 978. Here, the steps taken by Respondents are consistent with the facts of the above cases. Respondents asked the AAA to remove the arbitrator pursuant to AAA procedure immediately after becoming aware of the facts evidencing arbitrator bias. Respondents, in writing, timely objected, preserving their objection for judicial review. Therefore, the Appellate Court decision is consistent with federal precedent and need not be reviewed.

Petitioners, on the other hand, cite inapposite case law. For example, Petitioners cite *York Hannover Holding A.G. v. American Arbitration Association et al.*, 92 Civ. 1643 (CSH), 1993 WL 159961, 1993 U.S. Dist. LEXIS 6192 (S.D.N.Y. May 11, 1993). There, the court deferred to a AAA determination regarding arbitrator partiality. That case turned upon the party's attempt to use the court to intervene in the ongoing arbitration proceedings. The court began by outlining the limited ability of the court to interfere with ongoing arbitration proceedings. The court then noted that AAA Commercial Arbitration Rule 19 set out the procedure for objecting to the continued service of an arbitrator. The court concluded that "[a]t *this point in the process*, the court must defer to the decision of the AAA." (Italics added). The court did not hold that deference would be afforded the AAA determination once the arbitrator issued a final award and the party petitioned the court to vacate the award based upon arbitrator bias.

Petitioners cite *First Options of Chicago Inc. v. Kaplan*, ____U.S.____, 115 S.Ct. 1920 for the proposition that courts misconstrue the FAA when they invoke state law or other concerns to override the parties' contractual terms. See, Petition for Cert. p. 12. From this proposition, Petitioners reason that the Appellate Court should have found the AAA's determination on arbitrator bias to be conclusive because the parties' agreement provided for arbitration

under AAA rules. Petition for Cert. p. 14. Petitioners continue to confuse FAA preemption of state law requiring a judicial forum for resolving disputes without arbitration, with the utilization of limited judicial review of arbitration awards.

First Options v. Kaplan supports Respondents' contentions. The Court held that the standard of review applied to an arbitrator's decision regarding arbitrability depended on whether the parties agreed to submit the issue of arbitrability to the arbitrator. *Id.* 1293. If "clear and unmistakable" evidence shows the parties agreed to arbitrate arbitrability, then the standard a court applies is the same as applied to arbitration decisions in general. *Id.* 1924. The Court explained "[i]n this manner the law treats silence or ambiguity about the question 'who (primarily) should decide arbitrability' differently from the way it treats silence or ambiguity about the question 'whether a particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement'—for in respect to this latter question the law reverses the presumption [Citation omitted]." *Id.* 1924. Agreement about submitting the question of arbitrability for decision by the arbitrator is fundamentally different from whether arbitration conclusively decides matters reserved for the courts upon a petition to vacate or confirm the award made on claims arbitrated.

Under Petitioners' reasoning, state and federal statutory grounds for judicial review of arbitrator partiality would be displaced—i.e., "who" finally decides arbitrator partiality would shift from the court to the AAA administrator—based upon Petitioners' urged construction of the parties' agreement and AAA Commercial Arbitration Rule 19. Parties reasonably expect that the statutory and decisional law basis for judicial review of an arbitrator's award remains intact. Petitioners' argument undermines not only legislative intent but also the expectation of the parties. The Appellate

Court correctly reasoned that AAA Commercial Arbitration Rule 19 should not be read to effect this shift in "who" ultimately decides arbitrator partiality.

"The standard of review that the [Court] must render in examining 'the record' [when the parties allege arbitrator bias] must be seen in light of the purpose of a court's function in confirming or vacating an arbitration award." *Health Services Management Corp. v. Hughes,* 975 F.2d at 1258. The court has a duty to adequately review the record for alleged instances of evident partiality or other arbitrator misconduct, *Id.,* at p. 1258, n. 3. The Appellate Court's reasoning is made especially compelling by pointing out that since the AAA received a significant fee for appointing Peterson, it had a vested business interest in not making a mid-arbitration decision to disqualify Peterson. This court need not disturb the Appellate Court's decision.

CONCLUSION

For the foregoing reasons, respondents respectfully request that the petition for a writ of certiorari be denied.

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Respectfully Submitted,

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